Vol 37

IN THE

Supreme Court of the United States

October Term, A. D. 1940.

No. 551

ANNA L. RAYMOND,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Your petitioner, Anna L. Raymond, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit, entered on June 22, 1940 (R. 153), affirming a decision of the United States Board of Tax Appeals, determining a deficiency in petitioner's income tax for the calendar year 1934 (R. 120).

OPINIONS BELOW.

The opinion of the United States Board of Tax Appeals (R. 104-112) and a dissenting opinion of Board Member Black (R. 112-114) are reported in 40 B. T. A. 244. Additional findings of fact made by the Board pursuant to petitioner's motion, have not been reported, but are in the Record (R. 120-129). The opinion of the Circuit Court of Appeals (R. 147-153) is reported in 114 F. (2d) 140.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on June 22, 1940 (R. 153). A petition for rehearing was seasonably filed and was denied without opinion on August 9, 1940 (R. 153, 175). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED.

During the years 1925 to 1930, the petitioner made nine annuity agreements with six charitable and educational institutions. Under these agreements petitioner transferred to the institutions $1,246,906.76, and the institutions agreed to pay petitioner specified annuities aggregating $62,500.00 a year during her life (R. 25-28, 33-49). The aggregate payments received by petitioner under each agreement from its execution until December 31, 1934, were less than the amount transferred by petitioner to the institution under such agreement (R. 28-29).

The underlying issue is whether any part of the annuity payments received by petitioner in 1934, was taxable income. This issue presents the following questions:

1. Whether the consideration paid by petitioner for the annuities, within the meaning of Section 22(b)(2) of the Revenue Act of 1934,* or for the purpose of determining gain under Section 22(a), consisted of the entire amount transferred by her under the annuity agreements and required by the institutions as a condition for the agreements, or whether it consisted of only the average prices charged by insurance companies for similar annuities, as held below.

2. Whether Section 22(b)(2) of the Revenue Act of 1934, in so far as it includes in gross income in each year, three per cent of the consideration paid for an annuity, before the entire consideration has been recovered, should be construed to apply to annuities paid by

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* The Revenue Act of 1934, in Section 22(b)(2), provides for the first time that annuity payments received to the extent of three per cent of the "consideration paid" for the annuity are taxable income in each year, and that only the remainder shall be excluded from gross income, until the aggregate amount so excluded from gross income equals the "consideration paid". Thereafter the entire payments received are taxable. Under prior tax laws the entire payments received were exempt from tax until the aggregate amount received equaled the "consideration paid". The pertinent provisions of Section 22(b)(2) of the 1934 Act are set forth in Appendix A, page 39. The pertinent provisions of corresponding sections of prior revenue acts are set forth in Appendix B, pages 42-45.

charitable corporations, or to annuities purchased before the passage of the 1934 Act.

3. Whether Section 22(b)(2) of the Revenue Act of 1934, if applicable to petitioner's annuities, is unconstitutional and void, for the reason that it imposes a direct tax on capital without apportionment among the States and therefore violates the provisions of Article I, Section 2, Clause 3, and of Article I, Section 9, Clause 4 of the Constitution of the United States; or for the further reason that it is so arbitrary and capricious as to violate the due process clause of the Fifth Amendment to the Constitution.

The petitioner has from the beginning of this case, before the Board of Tax Appeals (R. 13, 23-24) and in the Circuit Court of Appeals (R. 136), challenged the constitutionality of the statute and relied upon the above mentioned Constitutional provisions.

STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved will be found in Appendix A, *infra,* pages 39-41.

The Constitutional provisions relied on are set forth in Appendix C, *infra,* page 50.

SUMMARY STATEMENT OF THE FACTS INVOLVED.

There is no dispute on the facts. The dates of petitioner's annuity agreements, the names of the institutions, the value of the property transferred by petitioner, and the amounts of the annuities, were as follows (R. 28):

Date of Agreement	Institution	Value of Property Transferred	Annuity
July 24, 1925	Art Institute of Chicago....	$ 98,937.50	$ 5,000.00
July 27, 1925	Field Museum of Natural History	302,150.00	15,000.00
Aug. 4, 1925	St. Luke's Hospital.........	98,265.00	5,000.00
Aug. 5, 1925	University of Chicago........	100,831.67	5,000.00
Dec. 1, 1925	Field Museum of Natural History	198,772.09	10,000.00
Feb. 15, 1926	Art Institute of Chicago....	200,000.00	10,000.00
May 7, 1926	Northwestern University ...	150,000.00	7,500.00
Aug. 10, 1927	Northwestern University ...	50,000.00	2,500.00
May 22, 1930	Children's Memorial Hospital	47,950.50	2,500.00
	Totals	$1,246,906.76	$62,500.00

Petitioner was born on January 21, 1854, and at the date of execution of the first agreement, July 24, 1925, she was 71½ years old (R. 29).

Except for the first agreement, which was evidenced by letters (R. 25, 33-34), all of the agreements were formal written contracts executed by petitioner and the respective institutions (R. 26-28, 35-49). They were all substantially identical in their language and form, except as to dates and amounts. The agreements all contained a provision substantially the same as the following, which appears in the contract dated August 4, 1925, with St. Luke's Hospital (R. 38):

> "Second: Said party of the second part [St. Luke's Hospital], in consideration of the transfer to it of the securities and stocks hereinabove scheduled by said party of the first part [Anna L. Raymond], covenants and agrees to pay to said party of the

first part in each and every year during her life an annuity of Five Thousand Dollars ($5,000), . . ."

The "securities and stocks" referred to in the above provision constituted the entire amount transferred by petitioner under the agreement.

The Board of Tax Appeals found, in effect, that the petitioner asked the institutions for and received from them the largest annuities which they were willing to pay in return for the property transferred; that these institutions have made approximately eighty-four annuity agreements in the aggregate, including the nine made with petitioner; that the rate of the annuities payable under petitioner's agreements (five per cent) was substantially the same as under all other annuity agreements made by these institutions; and that the institutions were not willing and could not afford to agree to pay the annuities for the prices charged for similar annuities by insurance companies (R. 124-127).

The aggregate payments received by petitioner under each agreement, from its execution to December 31, 1934, were less than the value of the property transferred by petitioner to the institution under such agreement (R. 28-29). At the end of the year involved petitioner had not recovered her capital, or the consideration paid for the annuity.

COMMISSIONER'S DETERMINATION.

The Commissioner of Internal Revenue determined that the "consideration paid" for the annuities was not the amount actually paid, but was only an amount equal to the present worth of the annuities at the date of the agreements, computed in accordance with Table A contained in Treasury Regulations 80 relating to the federal estate tax, which is based on the Actuaries' or Combined Experience Table of Mortality; and that the total consideration paid for all nine annuities was only $354,639.91 (R. 16, 30, 91, 94).

The Commissioner included in petitioner's gross income for 1934 the entire amount of the first eight annuities, or $60,000.00. He also included in gross income for that year, under his construction of Section 22(b)(2) of the 1934 Act, an amount equal to three per cent of the consideration computed by him for the ninth annuity (R. 18, 30-31, 94).

Petitioner appealed to the Board of Tax Appeals (R. 3), contending that the consideration which she paid was the entire amount required by the institutions, and that no part of the annuities received in 1934 was taxable income (R. 12-13).

ACTION OF BOARD OF TAX APPEALS.

The Board adopted the Commissioner's determination, that only a part of the amount transferred by petitioner was the "consideration paid" for the annuities. However, the Board concluded that the Actuaries' Mortality Table, on which the Commissioner's computation was based, was

outmoded, having been prepared in Great Britain in 1843 from experience data which have long since been regarded in this country as obsolete (R. 110). The Board therefore substituted another hypothetical "consideration," also less than the amount actually paid, and increased the amount of the so-called "consideration" from the Commissioner's figure of $354,639.91, to the average prices at which petitioner could have purchased her annuities from five large American insurance companies, or $528,745.52 for all nine annuities (R. 82, 83, 104, 111, 119). The Board also held that Section 22(b)(2) of the 1934 Act was constitutional (R. 111-112).

The aggregate payments received by petitioner prior to and during 1934 under the first seven agreements exceeded the insurance company prices for similar annuities (R. 106), and the Board included in petitioner's gross income the amount of such excess (R. 111, 119). The aggregate payments received under the last two agreements through the year 1934, were less than the insurance company prices for similar annuities (R. 106), and the Board, acting under its construction of Section 22(b)(2) of the 1934 Act, included in petitioner's income three per cent of the "consideration" for those annuities as determined by the Board (R. 111, 119). The total amount of the annuity payments held taxable by the Board in 1934 was $28,138.66.*

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* Under the Board's conclusion regarding the amount of the consideration, the entire amount of the first seven annuities, or $57,500.00, will constitute taxable income of petitioner in each year after 1934. The entire amounts of the last two annuities ($2,500.00 each) will become taxable in 1937 and 1939, respectively.

In a dissenting opinion Board Member Black concluded that the entire amount transferred by petitioner under the agreements was the consideration paid for the annuities (R. 112-114).

Petitioner appealed to the Circuit Court of Appeals (R. 129), but the Commissioner did not appeal.

ACTION OF CIRCUIT COURT OF APPEALS.

The decision of the Board of Tax Appeals was affirmed by the Circuit Court of Appeals (R. 153), in an opinion which summarily concluded that the amount paid by the petitioner for the annuities was in excess of both their "fair" and "actual cost", and that Section 22(b)(2) was applicable and valid (R. 152-153). The Court's opinion discloses a misconception of the statutory provision and of petitioner's contentions. It contains no discussion of the issues nor any reference to the many applicable authorities. We respectfully refer this Court to the petition for rehearing (R. 157-173), which reviews the misapprehensions of the Circuit Court of Appeals. That will not be repeated here. The petition for rehearing was denied without opinion (R. 175).

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

1. In holding that the consideration paid for petitioner's annuities, within the meaning of Section 22(b)(2) of the Revenue Act of 1934, did not exceed the average prices at which similar annuities could have been purchased from five American life insurance companies.

2. In failing to hold that the entire amount transferred by petitioner under the annuity agreements was the consideration paid for the annuities, within the meaning of Section 22(b)(2) of the Revenue Act of 1934.

3. In failing to hold that the entire amount transferred by petitioner under the annuity agreements was the cost basis for determining petitioner's gain from the annuities under Section 22(a) of the Revenue Act of 1934.

4. In holding that Section 22(b)(2) of the Revenue Act of 1934 applies to annuities paid by charitable corporations.

5. In holding that Section 22(b)(2) of the Revenue Act of 1934 applies to annuities purchased before its passage.

6. In holding that Section 22(b)(2) of the Revenue Act of 1934, in so far as it includes in petitioner's gross income for 1934, an amount equal to three per centum of the consideration paid for her annuities, before the entire consideration has been recovered, is constitutional and valid.

7. In failing to hold that Section 22(b)(2) of the Revenue Act of 1934 imposes a direct tax on capital with-

out apportionment among the States and contravenes Article I, Section 2, Clause 3, and Article I, Section 9, Clause 4, of the Constitution of the United States.

8. In failing to hold that Section 22(b)(2) of the Revenue Act of 1934 is so arbitrary and capricious as to contravene the due process clause of the Fifth Amendment to the Constitution of the United States.

9. In holding that any part of the annuity payments received by petitioner in the year 1934 constituted taxable income of petitioner.

10. In holding that petitioner was liable for any income tax for the year 1934.

11. In affirming the decision of the United States Board of Tax Appeals.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

1. In holding that the consideration paid for petitioner's annuities, within the meaning of Section 22(b)(2) of the Revenue Act of 1934, was less than the entire amount transferred by petitioner and uniformly required by the institutions, and did not exceed the average prices charged by insurance companies for similar annuities, the Circuit Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court.

2. In holding that Section 22(b)(2) of the Revenue Act of 1934 applies to annuities paid by charitable

corporations, the Circuit Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court.

3. In holding that Section 22(b)(2) of the Revenue Act of 1934 applies to annuities purchased before its passage, the Circuit Court of Appeals has decided a federal question in a way probably in conflict with applicable decisions of this Court, holding that tax laws should not be given a retroactive effect. (*Shwab* v. *Doyle*, 258 U. S. 529, 534-537; *Lewellyn* v. *Frick*, 268 U. S. 238, 251-252; *Blodgett* v. *Holden*, 275 U. S. 142, 148-149; *Helvering* v. *Helmholz*, 296 U. S. 93, 98; *Hassett* v. *Welch*, 303 U. S. 303, 307, 314.)

4. In holding that Section 22(b)(2) of the Revenue Act of 1934 does not impose a direct tax on capital, and does not violate the provisions of Article I, Section 2, Clause 3, and Article I, Section 9, Clause 4, of the Constitution of the United States, the Circuit Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court, and has decided a federal question in a way probably in conflict with applicable decisions of this Court. (*Burnet* v. *Logan*, 283 U. S. 404, 412-414; *Eisner* v. *Macomber*, 252 U. S. 189, 205-207; *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179, 185; *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170; *Goodrich* v. *Edwards*, 255 U. S. 527, 535.) The decision is also in probable conflict with numerous decisions of other Federal Courts and the United States Board

of Tax Appeals, holding that where the receipt of future payments is contingent on unpredictable events, no income is received until the capital has been recovered. (*Helvering* v. *Drier*, 79 F. (2d) 501; *Commissioner* v. *Speyer*, 77 F. (2d) 824; *Heiner* v. *Mellon*, 89 F. (2d) 141; *Letts* v. *Commissioner*, 84 F. (2d) 760; *Florence M. Quinn* v. *Commissioner*, 35 B. T. A. 412; *Alvina Ludorff et al., Executors* v. *Commissioner*, 40 B. T. A. 32; *Thomas A. O'Donnell* v. *Commissioner*, 25 B. T. A. 956, affirmed 64 F. (2d) 634; *Rocky Mountain Development Co.* v. *Commissioner*, 38 B. T. A. 1303.)

5. In holding that Section 22(b)(2) of the Revenue Act of 1934 is not so arbitrary and capricious as to violate the due process clause of the Fifth Amendment to the Constitution of the United States, the Circuit Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court, and has decided a federal question in a way probably in conflict with applicable decisions of this Court. (*Hoeper* v. *Tax Commission*, 284 U. S. 206, 215; *Schlesinger* v. *Wisconsin*, 270 U. S. 230, 240; *Heiner* v. *Donnan*, 285 U. S. 312, 325-329; *Nichols* v. *Coolidge*, 274 U. S. 531, 542; *Blodgett* v. *Holden*, 275 U. S. 142, 147; *Untermyer* v. *Anderson*, 276 U. S. 440, 445; *Helvering* v. *Helmholz*, 296 U. S. 93, 98.)

The above questions are of far-reaching importance because their decision will determine the extent of taxability of all annuities paid by charitable corporations, under the new provision first adopted in the Revenue

Act of 1934, and carried forward in subsequent acts. It is well known that the aggregate number and amount of such annuities are very large. The extent of taxability of such annuities has been surrounded with uncertainty, and that uncertainty has not been removed by the Circuit Court of Appeals in this case.

Until the correct principle regarding the amount of consideration paid for such annuities is determined by this Court, the Commissioner can continue to apply opposite rules to different taxpayers, depending on which rule will produce the largest tax at the time from that particular taxpayer. That the Commissioner has done this is evidenced by a comparison of the instant case with *F. A. Gillespie* v. *Commissioner*, 38 B. T. A. 673 (1938). There, the contention now made by this petitioner was urged by the Commissioner, since there it resulted in a larger tax, and it was upheld by the Board. A decision by this Court is necessary to establish a single rule to be applied uniformly, regardless of the resulting tax liability in each case. See *Estate of Sanford* v. *Commissioner*, 308 U. S. 39, 42.

The constitutionality of this new provision of the 1934 Act has been in doubt since before its passage. In the Senate debate on the provision, several Senators expressed the opinion that it would impose a tax on capital.* Its

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* Congressional Record, 73d Congress, 2d Session, Vol. 78, Part 6:

Page 5911:

"Mr. Hebert. . . . Let us assume that a man pays a premium of $10,000 for an annuity. Surely until

constitutionality was questioned in an article entitled, "The Revenue Act of 1934", by George Grayson Tyler and John P. Ohl, in University of Pennsylvania Law Review, Volume 83, page 607, at page 633, Footnote 200 (March, 1935). It has also been more recently challenged in the cases of *F. A. Gillespie* v. *Commissioner*, 38 B. T. A. 673 (1938), and *Title Guarantee & Trust Co., Executor, Estate of Mary A. Bedford* v. *Commissioner*, 40 B. T. A. 475 (1939). This provision is probably the first attempt to impose an income tax based, not on the income which each taxpayer actually receives, but on the estimated aver-

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he receives back from the company the sum of $10,000, there has been no income to him, and it is just as if he took the $10,000 and put it underneath the mattress and took away from it $1,000 each year for 10 years."

Page 5915:

"Mr. Bone. Mr. President, in view of the Senator's argument that this tax is an invasion of the corpus of the property, diminishing it year by year, I gather that the Senator's idea is that this is, in effect and by indirection, a capital levy rather than a tax on income."

"Mr. Hebert. To the extent that we tax something that is not there, of course, it is a capital levy."

. . . .

"Mr. Smith. I am perfectly in sympathy with the proposition of the Senator, for the reason that until the annuitant has received back—whether the time be short or long—the amount he paid for his annuity, he has earned nothing."

Page 5916:

"Mr. Austin. . . . The pending bill undertakes to tax a return of the capital and nothing more, up to the time when the annuitant has received the whole of the amount of the consideration paid by him. . . ."

age income of a large class of taxpayers. The constitutionality of the provision will remain in doubt until it is determined by this court.

CONCLUSION.

Wherefore, it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Seventh Circuit should be granted.

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COMMISSIONER OF INTERNAL REVENUE.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINIONS BELOW.

References to the opinions below are supplied in the Petition (page 2).

STATEMENT OF THE CASE.

A statement of the case has been given in the Petition (pages 4-9), and to avoid duplication is not repeated.

SPECIFICATION OF ERRORS.

The errors intended to be urged are those specified in the Petition (pages 10-11).

SUMMARY OF ARGUMENT.

1. The consideration paid for petitioner's annuities, within the meaning of Section 22(b)(2) of the Revenue Act of 1934, or for the purpose of determining gain under Section 22(a), was the entire amount transferred by petitioner under the agreements.

(a) The entire amount transferred by petitioner was the exchange or price required and received by the institutions for the annuities.

(b) The language of the statute (the "consideration paid") should be read in its natural and ordinary sense. The total amount transferred is universally called the consideration for such annuities by the parties.

(c) The Treasury Regulations, impliedly approved by Congress, indicate that the usual amount required by charitable corporations for annuities is the consideration paid for them within the meaning of the Revenue Acts.

(d) The conclusion of the Circuit Court of Appeals that the consideration did not exceed the prices charged by insurance companies for similar annui-

ties is irreconcilable with the admitted facts that the institutions were unwilling and could not afford to agree to pay the annuities for such consideration.

2. Section 22(b)(2) of the Revenue Act of 1934 should be construed not to apply to petitioner's annuities.

(a) Congress did not intend that Section 22(b)(2) should apply to annuities paid by charitable corporations.

(b) Section 22(b)(2) should be construed not to apply to annuities purchased before its passage.

3. Section 22(b)(2) of the Revenue Act of 1934, if and in so far as it includes in petitioner's gross income for 1934, three per cent of the consideration paid for her annuities, before the entire consideration has been recovered, is unconstitutional and void.

(a) The statute imposes a direct tax on capital without apportionment among the states according to population, and contravenes the provisions of Article I, Section 2, Clause 3, and of Article I, Section 9, Clause 4, of the Constitution of the United States. Until the consideration paid for an annuity has been recovered, the annuity payments are wholly a return of capital and no part of them can constitute income.

(b) The statute imposes a tax on estimated average income without regard to actualities, is arbitrary and capricious, and contravenes the due process clause of the Fifth Amendment to the Constitution.

ARGUMENT.

I.

The consideration paid for petitioner's annuities, within the meaning of Section 22(b) (2) of the Revenue Act of 1934, or for the purpose of determining gain under Section 22(a), was the entire amount transferred by petitioner under the agreements.

A. The Ordinary Meaning of Consideration.

Williston on Contracts (Rev. Ed. 1936), Volume 1, page 319, after giving as a definition of consideration, "the exchange or price requested and received by the promisor for the promise", continues:

> "This idea is undoubtedly the fundamental and as to most cases the generally accepted idea of consideration at the present time. It is in this sense that the word is used in this treatise and in the Restatement of Contracts."

Similar definitions are given in the American Law Institute's Restatement of the Law of Contracts (1932) Volume 1, pages 80-81; and in *Phoenix Life Insurance Company* v. *Raddin*, 120 U. S. 183, 197.

In the instant case, the annuity agreements could not have stated more clearly that the entire amount transferred by petitioner was the consideration paid for the annuities (R. 35-48). This is confirmed by the Board's

Additional Findings of Fact (R. 124-127). Petitioner asked for and received the largest annuities which the institutions were willing to pay for the amount transferred. The rate of the annuities was substantially the same as under all other annuity agreements made by the institutions. The entire amount transferred by petitioner was the exchange or price requested and received by the institutions for their promises.

The decision of the Circuit Court of Appeals is contrary to *Continental Illinois Bank and Trust Co.* v. *Blair,* 45 F. (2d) 345, 347 (C. C. A. 7th, 1930), and *F. A. Gillespie* v. *Commissioner,* 38 B. T. A. 673, 676 (1938). Neither of these cases was mentioned by the Circuit Court of Appeals.

B. The Language of Tax Statues Should Be Read in its Ordinary and Natural Sense.

The popular or received import of words furnishes the general rule for the interpretation of public laws. *Old Colony Railroad Co.* v. *Commissioner,* 284 U. S. 552, 560; *Woolford Realty Co.* v. *Rose,* 286 U. S. 319, 327; *Helvering* v. *San Joaquin Co.,* 297 U. S. 496, 499; *Deputy* v. *du Pont,* 308 U. S. 488, 493.

In *Old Colony Railroad Co.* v. *Commissioner,* 284 U. S. 552, this Court said, at page 561:

> "In short, we think that in the common understanding 'interest' means what is usually called interest by those who pay and those who receive the amount so denominated in bond and coupon, and that the words

of the statute permit the deduction of that sum, and do not refer to some esoteric concept derived from subtle and theoretic analysis."

So in the present case "consideration" means what is usually called consideration by those who pay and those who receive the amount so designated in these annuity agreements, and that amount is the total amount transferred under the agreement. A division of the amount transferred into "consideration" and "gift" obviously requires subtle and theoretic analysis—it is unreal.

The language throughout the opinion of the Circuit Court of Appeals suggests that the Court assumed that the measure of taxability of the annuities was the "cost" or the "fair cost" of the annuities, and that this "cost" was a theoretical concept different from the consideration paid for the annuities. For example, the Court stated as one of petitioner's arguments (R. 152):

"(2) The regulations in effect for several years (1918-32) (presumably approved by Congress) upheld as the 'cost' of charitable annuities, the entire consideration paid therefor."

However, there is no basis for such an assumption. Under Section 22(b)(2), which the Court held valid and applicable, the measure of taxability was not the "fair cost" of the annuities, but the consideration paid for them. (Appendix A, p. 39.) (See petition for rehearing, R. 158-159.)

It was stipulated that in entering into the annuity agreements, petitioner intended to benefit the institutions (R.

31). Such a motive is often an influence in the selection of the party with whom one will deal in any business transaction. This intention can not convert into a gift some indeterminable part of the consideration which was required and demanded by the institutions. Petitioner transferred to the institutions nothing in excess of their requirements.

Some persons may reasonably have a better opinion of the integrity and financial responsibility of a substantially endowed charitable institution than of life insurance companies. If such persons prefer to buy annuities from charitable institutions and to pay the higher prices which such institutions necessarily require, are they to be penalized? Nowhere in the revenue acts can be found any authority to the Commissioner to limit the measure of exemption of such annuities to something less than the consideration actually charged and paid.

The theory approved by the Circuit Court of Appeals results in the anomalous realization of both deductions and gains from what is obviously one transaction (R. 16-17). The theoretical "gain" is, in fact, only a return of the previous theoretical "gift". Both the "gift" and the "gain" rest entirely on speculation and conjecture. The determination of income taxes on such a basis has been condemned by this Court in *Burnet* v. *Logan,* 283 U. S. 404, 412-413.

C. The Treasury Regulations.

The provisions of the Revenue Acts and Treasury Regulations hereinafter referred to are set forth in Appendix B, pages 42-49.

The Revenue Acts of 1926, 1928 and 1932, contained identically the same provision, expressly excluding annuity payments from gross income until the total amount received exceeded the "consideration paid." The Revenue Acts of 1918, 1921 and 1924 contained a provision in different language but having the same effect. Thus substantially the same provision regarding annuity payments has been re-enacted in every Revenue Act from 1918 to and including 1932.

While in the 1934 Act the provision was changed to include a part of annuity payments in gross income, the "consideration paid" was continued as the basis of their measure of taxability.

Article 62 of Regulations 77 (1932) contained the following provision (Appendix B, page 48):

> "Art. 62. **Annuities and insurance policies.**—Annuities paid by religious, charitable, and educational corporations under an annuity contract are, in general, subject to tax to the extent that the aggregate amount of the payments to the annuitant exceeds the amounts paid as consideration for the contract. . . ."

Substantially the same provision was contained in all income tax regulations from 1918 to 1932, inclusive (see Appendix B, pages 45-48).

Article 22(a)-12 of Regulations 86, relating to the 1934 Act, provides:

> "Annuities paid by religious, charitable, and educational corporations under an annuity contract are, in general, subject to tax to the same extent as annuities from other sources paid under similar contracts. . . ." (See Appendix A, page 40.)

Thus all the income tax regulations from 1918 to 1934 inclusive contained an article dealing specifically with annuities paid by charitable corporations. Yet none of the regulations have ever suggested any division of the amount transferred for the annuities into consideration and gift, or any determination of the consideration paid by reference to mortality tables or insurance company prices. This silence of the regulations is a convincing indication that no such theoretical determination of the consideration was intended.

This Court has often declared that Treasury Regulations, long continued without substantial change, applying to substantially re-enacted provisions of the Revenue Acts, are deemed to have received Congressional approval. *Brewster* v. *Gage,* 280 U. S. 327, 337; *Hassett* v. *Welch,* 303 U. S. 303, 312; *Helvering* v. *Winmill,* 305 U. S. 79, 83; *Helvering* v. *R. J. Reynolds Tobacco Co.,* 306 U. S. 110, 115.

By re-enacting the statutory provision regarding annuities while the provision of the regulations regarding charitable annuities was continued from 1918 without substantial change, Congress has evidenced its intention that

at least the usual amount required by charitable institutions for annuities is the consideration paid for such annuities, within the meaning of the Revenue Acts.

D. The Court's Conclusion Is Irreconcilable with the Facts.

It is undisputed that the charities were not willing and could not afford to agree to pay the annuities for only the prices charged by insurance companies, for the reason that they made only a few annuity agreements and could not rely on average life expectancies or mortality tables. This appears from the Board's Additional Findings of Fact (R. 125-127, Pars. 6, 8, 11).

In its opinion the Board said (R. 109):

> "The testimony of persons speaking for the several charitable organizations all shows that the institutions were not making a business of selling annuities, that such contracts as these were few and that they could not afford to and would not make an annuity contract with petitioner upon terms as favorable to her as she could get from an insurance company, the point being that the amount received was regarded by them as the consideration for the annuities."

During the years when petitioner's annuity agreements were made, the premium rates of American insurance companies for annuities were based on the American Annuitants' Mortality Table (R. 79). That table indicates a life expectancy for females at age 72 of 11.34 years (R. 81, 102). The petitioner passed her eighty-sixth birthday on January 21, 1940. Therefore if the consideration

for the annuities had been only what the Circuit Court of Appeals has held it to be, the institutions in all probability would already have suffered net losses.

The admitted facts are simply irreconcilable with the conclusion of the majority of the Board and the Circuit Court of Appeals that the charities made these agreements in consideration only for amounts charged by insurance companies or less. The facts compel the conclusion that the consideration paid was substantially greater than insurance company prices.

II.

Section 22(b) (2) of the Revenue Act of 1934 should be construed not to apply to petitioner's annuities.

A. Congress Did Not Intend That Section 22(b) (2) Should Apply to Annuities Paid by Charitable Corporations.

In the debate in the Senate on the new provision, the following discussion occurred between Senator Austin and Senator Harrison, the chairman of the Senate Finance Committee, having charge of the 1934 Act (Cong. Rec., Vol. 78, Part 6, page 5916):

> "Mr. Austin: . . . At this point may I inquire of the chairman of the committee whether it is his understanding that this measure would apply to hospitals and universities, which obtain a large amount of their endowments by selling annuity contracts? Is that the interpretation which would be placed upon the measure?
>
> "Mr. Harrison: Mr. President, it does not apply

to them at all. It applies only to persons receiving income. It does not apply to them.

. . . .

"Mr. Austin: . . . Assume that a hospital has received from a philanthropist $100,000 for immediate use by the hospital in erecting buildings, in consideration of which the hospital promises to pay to the donor as an annuity a sum corresponding to 5 per cent annually of the amount of the gift. Would the receiver of that income be a taxpayer, under this provision of the measure?

"Mr. Harrison: It does not apply to him."*

In several cases this Court has given consideration to Congressional debates, and particularly to statements of the chairman of a committee, having charge of a pending bill, as disclosing the intention and understanding of Congress with respect to the scope of the Act. *Hassett* v. *Welch*, 303 U. S. 303, 310; *United States* v. *St. Paul, Minneapolis & Manitoba Railway Co.*, 247 U. S. 310, 316-318; *United States* v. *San Francisco*, 310 U. S. 16, 21-25, 60 Sup. Ct. 749, 752-755.

The report of the Ways and Means Committee of the House on the 1934 Act (Appendix D, page 51) supports the new provision of Section 22(b)(2) by the following statements:

". . . Payments to annuitants are, in fact, based upon mortality tables which purport to reflect a rate

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* This answer of Senator Harrison was omitted from the excerpts from the Senate debate set forth in the footnote in the opinion of the Circuit Court of Appeals (R. 151).

of return sufficient to enable the annuitant to recover his cost and in addition thereto a low rate of return on his investment. The change continues the policy of permitting the annuitant to recoup his original cost tax-free. . . ."

Those statements are not true with respect to annuities paid by charities. Such annuities are not and necessarily cannot be based upon mortality tables, and the change in the law does not permit such an annuitant to recoup his original cost tax-free. If this new provision had been applicable to these annuities in 1925, petitioner could not have recovered her cost tax-free unless she had lived for fifty years after the date of the agreements, or past the age of 121 years.*

B. Section 22(b)(2) of the 1934 Act Should Be Construed Not to Apply to Annuities Purchased Before Its Passage.

Before the passage of the 1934 Act, no part of annuity payments had been regarded as income until the entire consideration for the annuity had been recovered. Petitioner transferred her capital, irrevocably and beyond recall, years before the passage of the 1934 Act, at a time

* The Circuit Court of Appeals concluded that annuities are not exempt from taxation because paid by a charitable corporation (R. 152). Such annuities will not be exempt even if they are not subject to Section 22(b)(2). After the consideration paid for such annuities has been wholly recovered, the entire amount of annuity payments thereafter received will be subject to tax as gain under Section 22(a) of the Revenue Act (Appendix A, page 39). Such annuities will continue to be taxed in the same manner as under all prior Revenue Acts.

when the imposition of a tax on the annuity payments could not have been foreseen. She cannot now rescind or revoke the agreements nor recover her capital except through the annuity payments. The law thus taxes the return of petitioner's capital pursuant to contracts previously made, and in effect taxes transactions consummated nine years before.

This Court has repeatedly held that a new provision of the estate tax law should not be applied to transfers made before its passage. (*Shwab* v. *Doyle,* 258 U. S. 529, 534-537; *Lewellyn* v. *Frick,* 268 U. S. 238, 251-252; *Blodgett* v. *Holden,* 275 U. S. 142, 148-149; *Helvering* v. *Helmholz,* 296 U. S. 93, 98; *Hassett* v. *Welch,* 303 U. S. 303, 307, 314.) Petitioner contends that the principle of those decisions is applicable here.

III.

Section 22(b) (2) of the Revenue Act of 1934, if and in so far as it includes in petitioner's gross income for 1934, three per cent of the consideration paid for her annuities, before the entire consideration has been recovered, is unconstitutional and void.

A. Section 22(b) (2) Imposes a Direct Tax on Capital Without Apportionment Among the States According to Population, and Contravenes the Provisions of Article I, Section 2, Clause 3, and of Article I, Section 9, Clause 4, of the Constitution of the United States.

Income has been defined as the gain derived from capital, from labor, or from both combined, including profit gained through a sale or conversion of capital assets. *Eisner* v. *Macomber,* 252 U. S. 189, 207; *Goodrich* v. *Edwards,* 255 U. S. 527, 535; *Bowers* v. *Kerbaugh-Empire Co.,* 271 U. S. 170, 174; *Taft* v. *Bowers,* 278 U. S. 470, 481.

In *Bowers* v. *Kerbaugh-Empire Co.,* 271 U. S. 170, 175, it was held that there could not be taxable income or a gain when the result of the whole transaction was a loss.

In *Doyle* v. *Mitchell Brothers Co.,* 247 U. S. 179, this Court said, at page 185:

> "In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration."

Where the receipt of future payments is contingent upon unpredictable events, no income is received until the capital has been wholly recovered. This rule has been applied to various states of fact. Some of the cases are as follows:

(a) Partial payments received under awards by the Mixed Claims Commission, for property taken by the German Government during the World War: *Commissioner* v. *Speyer*, 77 F. (2d) 824, (C. C. A. 2nd, 1935); *Helvering* v. *Drier*, 79 F. (2d) 501, 503, (C. C. A. 4th, 1935).

(b) Liquidating dividends received from a corporation: *Letts* v. *Commissioner*, 84 F. (2d) 760, (C. C. A. 9th, 1936); *Florence M. Quinn* v. *Commissioner*, 35 B. T. A. 412 (1937); *Alvina Ludorff et al., Executors* v. *Commissioner*, 40 B. T. A. 32 (1939).

(c) Amounts received by partners from the liquidation of a partnership: *Heiner* v. *Mellon*, 89 F. (2d) 141, 143, (C. C. A. 3rd, 1937).

(d) Payments to be received from oil produced from certain property: *Thomas A. O'Donnell* v. *Commissioner*, 25 B. T. A. 956, 961 (1932), affirmed 64 F. (2d) 634, (C. C. A. 9th, 1933); *Rocky Mountain Development Co.* v. *Commissioner*, 38 B. T. A. 1303 (1938). Cf. *Commissioner* v. *Edwards Drilling Co.*, 95 F. (2d) 719 (C. C. A. 5th, 1938).

This Court approved the above rule in *Burnet* v. *Logan*, 283 U. S. 404. There the taxpayer had sold certain cor-

porate stock for cash and a promise by the purchaser to pay in the future sixty cents for each ton of ore taken from a certain mine. This Court held that until the total amount received by the taxpayer should equal her capital, no part of the payments was taxable income. The Court said, on page 412:

> "As annual payments on account of extracted ore come in they can be readily apportioned first as return of capital and later as profit. The liability for income tax ultimately can be fairly determined without resort to mere estimates, assumptions and speculation. When the profit, if any, is actually realized, the taxpayer will be required to respond. The consideration for the sale was $2,200,000.00 in cash and the promise of future money payments wholly contingent upon facts and circumstances not possible to foretell with anything like fair certainty. The promise was in no proper sense equivalent to cash. It had no ascertainable fair market value. The transaction was not a closed one. Respondent might never recoup her capital investment from payments only conditionally promised. Prior to 1921 all receipts from the sale of her shares amounted to less than their value on March 1, 1913. She properly demanded the return of her capital investment before assessment of any taxable profit based on conjecture."

The same reasoning is equally applicable to annuities, since an annuity agreement is equally "the promise of future money payments wholly contingent upon facts and circumstances not possible to foretell with anything like fair certainty". It is equally true that an annuitant may "never recoup her capital investment from payments

only conditionally promised''; and that an annuitant may properly demand ''the return of her capital investment before assessment of any taxable profit based on conjecture.''

In the *Burnet* case, this Court further said, on page 414:

> ''If a sum equal to the value thus ascertained had been invested in an annuity contract, payments thereunder would have been free from income tax until the owner had recouped his capital investment. We think a like rule should be applied here.''

One who purchases an annuity for $100,000.00 and dies after receiving but $10,000.00 in payments, has not realized any gain. There can be no gain from an annuity until its cost has been recovered.

Congress cannot transform capital into income by statute, nor impose a direct tax on capital without apportionment by calling capital ''income'', even under the Sixteenth Amendment. *Eisner* v. *Macomber,* 252 U. S. 189, 206; *Burk-Waggoner Oil Association* v. *Hopkins,* 269 U. S. 110, 114.

In *Taft* v. *Bowers,* 278 U. S. 470, this Court said, on page 481:

> ''Under former decisions here the settled doctrine is that the Sixteenth Amendment confers no power upon Congress to define and tax as income without apportionment something which theretofore could not have been properly regarded as income.''

Section 22(b)(2), if applicable, will surely tax capital of this petitioner. She was 71½ years old at the date of the first annuity agreement (R. 29). Under the statute, three per cent of the consideration, or three-fifths (3/5) of her five per cent annuity payments, is considered income, leaving only two per cent of the consideration as a return of capital in each year. If this provision had been applicable to petitioner's annuities in 1925, petitioner would not have recovered her entire capital tax-free unless she had lived for fifty years after the date of the agreements, or past the age of 121 years.

Considering only the actual effect of the new provision in 1934, by the end of 1933 petitioner had recovered $40,000.00 under the first agreement, or approximately forty per cent of the consideration paid (R. 106). If she should recover only two per cent of the consideration tax-free in each year thereafter, she could not recoup her entire capital unless she should live thirty years more, or past the age of 109 years.

Even if the extraordinary view of the Board as to the consideration paid for petitioner's annuities should be approved, the statute would still tax petitioner's capital. The consideration for the last two annuities, as determined by the Board, had not been recovered by the end of 1934 (R. 106, 111). The payments of those two annuities in 1934 were therefore wholly a return of capital; yet a portion of them was included in gross income under the statute (R. 111, 119).

Since the statute taxes a part of each annuity payment before the capital has been recovered, it imposes a direct tax on capital, which is not apportioned among the states, and it therefore violates Article I, Section 2, Clause 3, and Article I, Section 9, Clause 4 of the Constitution (Appendix C, page 50). *Eisner* v. *Macomber*, 252 U. S. 189, 205-206, 219.

B. Section 22(b)(2) Imposes a Tax on Estimated Average Income without Regard to Actualities, Is Arbitrary and Capricious, and Contravenes the Due Process Clause of the Fifth Amendment to the Constitution.

This contention of petitioner was not mentioned by the Circuit Court of Appeals, although urged by petitioner in her brief and in the oral argument.

The House Committee report said, of the new three per cent provision (Appendix D, page 51):

> "While the per cent used is arbitrary, it approximates the rate of return in the average annuity."

Not only the per cent used, but the entire plan of taxing part of each annuity payment as income, is arbitrary and capricious. The statute imposes a tax on each annuitant on the basis, not of his actual income, but of the estimated average income of all annuitants who purchase annuities at insurance company prices. The tax is based on a conclusive assumption of fact without regard to actualities.

An attempt to measure the tax on one person's income by reference to the income of others was condemned by this

Court in *Hoeper* v. *Tax Commission,* 284 U. S. 206, where it was said, on page 215:

> "We have no doubt that, because of the fundamental conceptions which underlie our system, any attempt by a state to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the Fourteenth Amendment. That which is not in fact the taxpayer's income cannot be made such by calling it income. Compare *Nichols* v. *Coolidge,* 274 U. S. 531, 540."

A statute which imposes a tax upon assumptions of fact without regard to actualities is so arbitrary and capricious as to violate the Fifth Amendment. *Schlesinger* v. *Wisconsin,* 270 U. S. 230, 240; *Heiner* v. *Donnan,* 285 U. S. 312, 325-329.

The arbitrary character of the statute is especially apparent if it is applied to petitioner's annuities, purchased years before the adoption of the new provision. The amount of petitioner's tax is made to depend on past lawful transactions, which at the time did not produce income and which are beyond recall. *Nichols* v. *Coolidge,* 274 U. S. 531, 542; *Blodgett* v. *Holden,* 275 U. S. 142, 147; *Untermyer* v. *Anderson,* 276 U. S. 440, 445; *Helvering* v. *Helmholz,* 296 U. S. 93, 98.

Conclusion.

In order to establish the correct measure of taxability of annuities paid by charities, and to dispel the doubt and confusion that result from the decision of the Circuit Court of Appeals, it is respectfully submitted that the writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A.

Revenue Act of 1934 and Treasury Regulations 86.

REVENUE ACT OF 1934, 48 STAT. 680:

"**Sec. 22. Gross Income.**

"(a) **General Definition.**—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . .

"(b) **Exclusions from Gross Income.**—The following items shall not be included in gross income and shall be exempt from taxation under this title:

. . . .

"(2) **Annuities, Etc.**— . . . Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year),

until the aggregate amount excluded from gross income under this title or prior income tax laws in respect of such annuity equals the aggregate premiums or consideration paid for such annuity. . . ."

Regulations 86 (1934):

"Art. 22(a)-12. **Annuities and insurance policies.**—Annuities paid by religious, charitable, and educational corporations under an annuity contract are, in general, subject to tax to the same extent as annuities from other sources paid under similar contracts. (See section 22(b)(2) and article 22(b)(2)-2.) . . . Amounts received as a return of premiums paid under life insurance, endowment, or annuity contracts, and the so-called 'dividend' of a mutual insurance company which may be credited against the current premium, are not subject to tax."

"Art. 22(b)(2)-2. **Annuities.**— . . . If an annuity is payable in annual installments, there shall be included in gross income only such portion of the amounts received in any taxable year as is equal to 3 per cent of the aggregate premiums or consideration paid for such annuity, whether or not paid during such year. If an annuity is payable in two or more installments over each 12-month period, such portion of each installment shall be taxable as is equal to 3 per cent of the aggregate premiums or consideration paid for such annuity, whether or not paid during the taxable year, divided by the number of installments payable during such year. As soon as the aggregate of the amounts received and excluded

from gross income equals the aggregate premiums or consideration paid for such annuity, the entire amount received thereafter in each taxable year must be included in gross income. The provisions of this article may be illustrated by the following examples:

"*Example (1):* A bought in 1933, for $50,000 consideration, a life annuity, payable in annual installments of $5,000. For the calendar year 1934 he would be required to include in gross income $1,500 of the $5,000 received during that year (3 per cent of $50,000), $3,500 being exempt. If A should live long enough to receive as exempt $50,-000, then all amounts he receives thereafter under the annuity contract would be included in gross income.

. . . ."

APPENDIX B.

Revenue Acts from 1918 to 1932, inclusive, and Treasury Regulations Promulgated Thereunder.

I.

Revenue Acts.

Revenue Act of 1918, 40 Stat. 1057:

"Sec. 213. That for the purposes of this title (except as otherwise provided in section 233) the term 'gross income'—

. . . .

"(b) Does not include the following items, which shall be exempt from taxation under this title:

. . . .

"(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;"

Revenue Act of 1921, 42 Stat. 227:

"Sec. 213. That for the purposes of this title (except as otherwise provided in section 233) the term 'gross income'—

. . . .

"(b) Does not include the following items, which shall be exempt from taxation under this title:

. . . .

"(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;"

REVENUE ACT OF 1924, 43 STAT. 253:

"Sec. 213. For the purposes of this title, except as otherwise provided in section 233—

. . . .

"(b) The term 'gross income' does not include the following items, which shall be exempt from taxation under this title:

. . . .

"(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;"

REVENUE ACT OF 1926, 44 STAT. 9:

"Sec. 213. For the purposes of this title, except as otherwise provided in section 233—

. . . .

"(b) The term 'gross income' does not include the following items, which shall be exempt from taxation under this title:

. . . .

"(2) Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract, but if such amounts (when added to amounts received

before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. . . ."

REVENUE ACT OF 1928, 45 STAT. 791:

"**Sec. 22. Gross Income.**

. . . .

"(b) **Exclusions from Gross Income.**—The following items shall not be included in gross income and shall be exempt from taxation under this title:

. . . .

"(2) **Annuities, Etc.**—Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. . . ."

REVENUE ACT OF 1932, 47 STAT. 169:

"**Sec. 22. Gross Income.**

. . . .

"(b) **Exclusions from Gross Income.**—The following items shall not be included in gross income and shall be exempt from taxation under this title:

. . . .

"(2) **Annuities, Etc.**—Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract, but if such amounts (when added to amounts

received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. . . ."

II.

Treasury Regulations.

REGULATIONS 45 (1918):

"ART. 47. **Annuities and insurance policies.**—Annuities paid by religious, charitable, and educational corporations under an annuity contract are subject to tax to the extent that the aggregate amount of the payments to the annuitant exceeds any amounts paid by him as consideration for the contract. . . . Where an insured receives under life insurance, endowment, or annuity contracts sums in excess of the premiums paid therefor, such excess is income for the year of its receipt. See article 72. . . ."

"ART. 72. **Proceeds of insurance.**—. . . (b) During his life only so much of the amount received by an insured under life, endowment or annuity contracts as represents a return, without interest, of premiums paid by him therefor is excluded from his gross income. See article 47. . . ."

REGULATIONS 62 (1921):

"ART. 47. **Annuities and insurance policies.**—Annuities paid by religious, charitable, and educational corporations under an annuity contract are subject to tax to the extent that the aggregate amount of the payments to the annuitant exceeds

any amounts paid by him as consideration for the contract. . . . Where an insured receives under life insurance, endowment, or annuity contracts sums in excess of the premiums paid therefor, such excess is income for the year of its receipt. See article 72. . . ."

"ART. 72. **Proceeds of insurance—Compensation—War pensions.**—. . . (b) During his life only so much of the amount received by an insured under life, endowment, or annuity contracts as represents a return, without interest, of premiums paid by him therefor is excluded from his gross income. See article 47. . . ."

REGULATIONS 65 (1924):

"ART. 47. **Annuities and insurance policies.**—Annuities paid by religious, charitable, and educational corporations under an annuity contract are subject to tax to the extent that the aggregate amount of the payments to the annuitant exceeds any amounts paid by him as consideration for the contract. . . . Amounts received by an insured as a return of premiums paid by him under life insurance, endowment, or annuity contracts, such as the so-called 'dividends' of a mutual insurance company which may be credited against the current premium, are not subject to tax. See article 72. . . ."

"ART. 72. **Proceeds of insurance—Compensation—Pensions.**—. . . The amount received by an insured under life insurance, endowment, or annuity contracts as a return, without interest, of premiums paid by him therefor is excluded from his gross income. See article 47. . . ."

Regulations 69 (1926):

"Art. 47. **Annuities and insurance policies.**—Annuities paid by religious, charitable, and educational corporations under an annuity contract are, in general, subject to tax to the extent that the aggregate amount of the payments to the annuitant exceeds the amounts paid as consideration for the contract. (But see section 213(b)(2) and article 72.) . . . Amounts received by an insured as a return of premiums paid by him under life insurance, endowment, or annuity contracts, such as the so-called 'dividends' of a mutual insurance company which may be credited against the current premium, are not subject to tax."

"Art. 72. **Proceeds of insurance— Compensation—Pensions.**—. . . Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract are excluded from gross income, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. (See article 47.) . . ."

Regulations 74 (1928):

"Art. 62. **Annuities and insurance policies.**—Annuities paid by religious, charitable, and educational corporations under an annuity contract are, in general, subject to tax to the extent that the aggregate amount of the payments to the annuitant exceeds the amounts paid as consideration for the contract.

But see section 22(b)(2) and article 82. . . . Amounts received by an insured as a return of premiums paid by him under life insurance, endowment, or annuity contracts, such as the so-called 'dividend' of a mutual insurance company which may be credited against the current premium, are not subject to tax."

"ART. 82. **Proceeds of insurance—Compensation—Pensions.**—. . . Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract are excluded from gross income, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. (See article 62.) . . ."

REGULATIONS 77 (1932):

"ART. 62. **Annuities and insurance policies.**—Annuities paid by religious, charitable, and educational corporations under an annuity contract are, in general, subject to tax to the extent that the aggregate amount of the payments to the annuitant exceeds the amounts paid as consideration for the contract. But see section 22(b)(2) and article 82. . . . Amounts received by an insured as a return of premiums paid by him under life insurance, endowment, or annuity contracts, such as the so-called 'dividend' of a mutual insurance company which may be credited against the current premium, are not subject to tax."

"ART. 82. **Proceeds of insurance—Compensation.** —. . . Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract are excluded from gross income, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. (See article 62.) . . ."

APPENDIX C.

Constitutional Provisions Relied on by Petitioner.

Constitution of the United States:

Article I, Section 2, Clause 3:

"Representatives and direct taxes shall be apportioned among the several States which may be included within this Union, according to their respective numbers, . . ."

Article I, Section 9, Clause 4:

"No capitation, or other direct, tax shall be laid, unless in proportion to the census or enumeration herein before directed to be taken."

Fifth Amendment to the Constitution:

"No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

APPENDIX D.

Congressional Committee Reports, relating to Section 22(b) (2) of the Revenue Act of 1934.

REPORT OF COMMITTEE ON WAYS AND MEANS OF THE HOUSE OF REPRESENTATIVES (73d Cong., 2d Sess., H. Rept. No. 704, p. 21):

"Section 22(b)(2). Annuities, etc.: The present law does not tax annuities arising under contracts until the annuitant has received an aggregate amount of payments equal to the total amount paid for the annuity. Payments to annuitants are, in fact, based upon mortality tables which purport to reflect a rate of return sufficient to enable the annuitant to recover his cost and in addition thereto a low rate of return on his investment. The change continues the policy of permitting the annuitant to recoup his original cost tax-free but requires him to include in his gross income a portion of the annual payments in an amount equal to 3 per cent of the cost of the annuity. While the per cent used is arbitrary, it approximates the rate of return in the average annuity.

"Statistics show that an increasing amount of capital is going into the purchase of annuities, with the result that income taxes are postponed indefinitely. The change merely places the return of this form of investment on the same basis as other forms of investment by taxing that portion of each payment which in fact constitutes income."

Report of Committee on Finance of the Senate (73d Cong., 2d Sess., S. Rept. No. 558, p. 23):

"Section 22(B)2. Annuities.

"The present law does not tax annuities arising under contracts until the annuitant has received an aggregate amount of payments equal to the total amount paid for the annuity. Payments to annuitants are, in fact, based upon mortality tables which purport to reflect a rate of return sufficient to enable the annuitant to recover his cost, and in addition thereto, a low rate of return on his investment.

"The House bill continues the policy of permitting the annuitant to recoup his original cost tax-free but requires him to include in his gross income a portion of the annual payments in an amount equal to 3 per cent of the cost of the annuity. While your committee is in agreement with the change made by the House, it was thought advisable to continue the policy of not taxing any portion of the amount received from an annuity until the aggregate amount of payments equal the total amount paid for the annuity in cases where the aggregate amount received by the annuitant from all his annuities is not more than $500. The following example illustrates the change made:

"Example: 'A,' an individual, received during the calendar year the following amounts from annuities: Annuity No. 1, $450; annuity No. 2, $300; and annuity No. 3, $150. In the case of annuity No. 1, 'A' prior to 1934 received aggregate payments equal to the aggregate premiums paid. In the case of annuity No. 1, 'A' reports the entire amount

of the annuity because all of his capital has been returned. In the case of annuity No. 2 and annuity No. 3, 'A' is required to include in gross income 3 per cent of the consideration paid for each such annuity. The $500 exemption will not apply in such a case because the total annuity payments received by 'A' during the taxable year exceed that amount."

Report of Conference Committee (73d Cong., 2d Sess., H. Rept. No. 1385, p. 17):

"Amendment No. 14: The House bill requires an annuitant to include in his gross income a portion of the annual receipts in an amount equal to 3 per cent of the cost of the annuity. The Senate amendment excepts from the House change persons whose aggregate receipts from annuities in the year do not exceed $500, and makes some minor changes in phraseology. The House recedes with an amendment rejecting the $500 exception."

IN THE

Supreme Court of the United States

October Term, A. D. 1940.

No. 551

ANNA L. RAYMOND,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

REPLY BRIEF FOR PETITIONER.

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TABLE OF AUTHORITIES CITED.

Cases.

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IN THE

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REPLY BRIEF FOR PETITIONER.

I.

Section 22(b)(2) is not applicable to petitioner's annuities.

A. The section does not apply to annuity contracts made with charitable institutions.

Respondent asserts that Senator Harrison, after first indicating that the section does not apply to a taxpayer who purchases an annuity from a charity, thereafter indicated an opposite view in the next few lines of the Con-

gressional Record. (Resp. Br. 6) We challenge that assertion. Plainly the meaning of Senator Harrison's subsequent statements was simply that if an individual should purchase an annuity from an insurance company and upon receiving the annuity payments should turn them over to a hospital, the section would apply to such payments. The Senator in no way modified his prior direct statement regarding annuities purchased from charities. (78 Cong. Rec., Part 6, page 5916.)

Petitioner's contention on this question is also based on the fact that the only grounds on which the section is supported in the Congressional Committee Reports clearly do not apply to annuities purchased from charities. (Pet. 28-29.)

B. Section 22(b)(2) does not apply to annuities purchased before its enactment.

The authorities cited by petitioner (Pet. 12, 30) hold that laws should not operate retroactively unless that intention be clearly declared. There is no declaration of such an intention in Section 22(b)(2).

Respondent relies on cases holding that a revenue act may impose a tax on income received during the year of the act's enactment, and may under certain conditions tax to the settlor the income of a trust created before the law's enactment. (Resp. Br. 7.) Those cases are inapplicable. The income there taxed had been universally recognized as income before the passage of the law; and in

all the cases involving income of trusts, the Court relied on the fact that the income was subject to the settlor's control or was used for his benefit. Therefore the imposition of the tax in those cases could reasonably have been foreseen.

No part of annuity payments received before recovery of their cost had been regarded as income before the enactment of the 1934 Act. It was not reasonably foreseeable when petitioner's annuity agreements were made that a part of the annuity payments would be taxed as income by a subsequent law.

II.

Section 22(b)(2) is unconstitutional.

Neither respondent's brief nor the Congressional Committee Reports quoted therein explain how any portion of annuity payments received before the recovery of their cost "does in fact constitute income." (Resp. Br. 7-8.) The mere assertion to that effect does not change the actual fact nor answer the numerous decisions which indicate the contrary. (Pet. 12-13, 31-34.)

Respondent's attempt to distinguish *Burnet* v. *Logan*, 283 U. S. 404, is unconvincing. (Resp. Br. 8.) That decision was based on the uncertainty of the royalty payments. An equal if not greater uncertainty attends the duration of life of any one individual. Respondent fails to mention any relevant difference in the character of royalty and annuity payments.

The respondent's attempted distinction of the *Logan* case on the ground that it involved no statute corresponding to Section 22(b)(2) wholly begs the question. It was there held that the royalty payments, depending on a contingency, were not subject to income tax, not because of the absence of an appropriate statutory provision, but because they were inherently a return of capital. Consequently any statute which taxed them without apportionment would have violated the Constitution. Neither in that case nor in this can a statute tax capital, without apportionment, as "income."

Respondent's contention that Section 22(b)(2) is analogous to Section 44(a) of the 1934 Act, is without merit. (Resp. Br. 8.) At the time of a sale on the installment plan, the total sale price which the buyer is obligated to pay is definitely known, and is not contingent upon the life of any individual. The vendor is sure to recoup his capital if the buyer's obligations are performed. Therefore the vendor's entire gain can at once be determined and taxed, and the revenue acts prior to 1926 so required. *Nuckolls* v. *United States*, 76 F. (2d) 357, 359 (C. C. A. 10th, 1935). Section 44(a) simply gives the seller *a privilege at his option* of postponing the tax until the receipt of the deferred payments. This privilege may be availed of or waived by any seller. This is clearly pointed out in the cases cited by respondent (Resp. Br. 9). If a seller has elected to postpone the tax, he obviously cannot object if a portion of each installment payment

is treated as income. That is a condition attached to the privilege.

Section 44(a) has not the slightest similarity to Section 22(b)(2), which without any election by the taxpayer taxes, as "income," a portion of annuity payments constituting a return of capital, although the aggregate amount which the taxpayer will recover is wholly contingent and unforeseeable.

III.

The consideration paid for the annuities was the entire amount transferred by petitioner.

If Section 22(b)(2) is inapplicable or invalid, then petitioner's tax liability for 1934 directly depends on the amount of the consideration paid for the annuities. If the entire amount transferred by petitioner was the consideration, as petitioner contends, no part of the annuity payments was income for 1934, and the judgment below was erroneous.

Even if Section 22(b)(2) should be considered applicable and valid, the amount of the consideration paid for the annuities will determine petitioner's tax liability for every year after 1934. Under the Board's view, the entire amount of the first seven annuities, or $57,500.00, will be taxable income in each year during petitioner's life. However, if the entire amount transferred by petitioner was the consideration paid, the consideration will not be recovered tax-free until after 1961, if Section 22(b)(2) be applied; and therefore until at least that year, only so

much of the first seven annuities as equals three per cent of the consideration paid for them, or approximately $34,000.00, will be taxable income in each year. The tax liability of petitioner for the six years from 1935 to 1940 inclusive has already accrued, and its determination will surely require a decision of this question.

A final decision regarding the amount of consideration paid for annuities purchased from charitable institutions will also determine the extent of taxability of all other such annuities, and will enable the Commissioner to treat them all consistently. If the decision below should be allowed to stand, the unfortunate and ill-considered statement of the Circuit Court of Appeals, that the sum which the Board found was the fair cost of the annuities is "more than the actual cost" (R. 152-153), may cause endless confusion. It is important that this question now be settled by this Court, in order to forestall additional litigation regarding the tax liability of petitioner and of all other annuitants of charities.

The respondent's contention that the transfers by petitioner were in part a gift does not answer petitioner's argument on this question. (Pet. 20-26.) An intention of both parties to a contract that one of them shall profit therefrom does not convert part of *the required exchange* into a gift.

The respondent supports the Board's conclusion regarding the amount of the consideration paid only on the grounds that petitioner furnished no other proof on the

question, and that petitioner suggests no other criterion which the Board could or should have adopted. (Resp. Br. 10.)

Petitioner has proved that the criterion used by the Board is arbitrary, erroneous, and contrary to the facts. (Pet. 26-27.) Petitioner's evidence shows that any criterion other than the entire amount transferred can rest only on speculation, conjecture and surmise; and that the only legitimate criterion of the consideration is the entire amount transferred by petitioner. (R. 124-127.)

If a taxpayer proves that the Board's determination of income tax is erroneous and excessive, the Board's decision should be reversed. The burden on the taxpayer is only to prove that the Board's determination is erroneous; not to show the correct tax, or to prove that no tax is due. *Helvering* v. *Taylor*, 293 U. S. 507, 512-516; *Laird* v. *Commissioner*, 85 F. (2d) 598, 601 (C. C. A. 3rd, 1936); *Wilson Coal Land Co.* v. *Commissioner*, 87 F. (2d) 185, 189 (C. C. A. 5th, 1937); *Clements* v. *Commissioner*, 88 F. (2d) 791, 793 (C. C. A. 8th, 1937).

Conclusion.

The decision below is erroneous, irreconcilable with the facts, and in conflict in principle with numerous decisions of this Court and of other Federal Courts. The case involves important questions which should now be settled

by this Court. The petition for a writ of certiorari should therefore be granted.

Respectfully submitted,

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CITATIONS

275785—40——1

In the Supreme Court of the United States

October Term, 1940

No. 551

Anna L. Raymond, petitioner

v.

Guy T. Helvering, Commissioner of Internal Revenue

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 104) is reported in 40 B. T. A. 244. The opinion of the Circuit Court of Appeals (R. 147) is reported in 114 F. (2d) 140.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 22, 1940. (R. 153.) A petition for rehearing was denied on August 9, 1940. (R. 175.) The petition for a writ of certiorari was filed on November 4, 1940. The jurisdiction of this

Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The petitioner, when over 70 years of age, transferred securities to several charitable institutions, which agreed to pay her annuities amounting to approximately 5 percent of the market value of the securities. Petitioner could have purchased similar annuities from an insurance company for less than one-half of the amount which she transferred to the charities. The questions are:

(1) Whether Section 22 (b) (2) of the Revenue Act of 1934 applies to annuities purchased from charitable institutions, and, if so, whether it applies to annuities purchased prior to the enactment of that Act.

(2) If Section 22 (b) (2) is applicable, whether it violates the Fifth or Sixteenth Amendments to the Constitution.

(3) If Section 22 (b) (2) is applicable and valid, whether the "consideration paid" for the annuities, within the meaning of Section 22 (b) (2), is the entire amount transferred to the charitable institutions, or only the amount for which petitioner could have purchased similar annuities from an insurance company.

STATUTE AND REGULATIONS INVOLVED

The statute and Regulations involved will be found in the Appendix, *infra*, pp. 12–15.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 105–106, 121–128) may be summarized as follows:

The taxpayer, when over 70 years of age, transferred securities having a fair market value of $1,246,906.76 to six charitable and educational institutions. The transfers were made pursuant to nine different contracts, each of which provided that the institution would pay the taxpayer a fixed annuity; in each case the annuity amounted to approximately five percent of the value of the securities transferred. The taxpayer was interested in the work and services of each of the institutions and intended by the contracts to benefit them as well as to acquire annuities. From time to time she had made outright contributions to these institutions aggregating over $400,000 and she had also contributed over $300,000 to similar institutions and community funds. (R. 105–106.)

Under the nine contracts, the taxpayer received annuities aggregating $62,500. She could have purchased annuities of this amount from any one of five large insurance companies for less than half of the value of the securities transferred by her. The prices at which such annuities could have been purchased, the value of the property transferred to the institutions, and the aggregate amount of the annuities received by the taxpayer are set forth in the Board's findings. (R. 105–106.)

In filing her income tax return for the year 1934, the taxpayer omitted from gross income the annuities received by her during that year on the theory that she had not yet recovered her capital. The Commissioner, however, determined that only part of the value of the securities transferred was the "consideration paid" for the annuities, within the meaning of Section 22 (b) of the Revenue Act of 1934, and that since the amounts received by the taxpayer aggregated more than the consideration paid, as he computed it, the excess was taxable gain (R. 107). He assessed a deficiency accordingly (R. 14–19).

The Board agreed with the Commissioner's determination that only a part of the amount transferred by petitioner was the consideration paid for the annuities. It held that petitioner could have purchased all of the annuities from an insurance company for $528,745.52, and that this should be considered the "consideration paid" within the meaning of Section 22 (b) (2) (R. 111, 119). Since the aggregate payments received by petitioner under the first seven agreements exceeded the "consideration paid", computed on this basis, the Board included in petitioner's gross income the amount of such excess (R. 106, 111, 119). With respect to the last two agreements, the aggregate payments received were less than the "consideration paid" computed on the basis of insurance company costs (R. 106); consequently, pursuant to the provisions of Section 22 (b) (2) the Board included in petition-

er's gross income three per cent of the consideration paid for these annuities, computed on the basis of insurance company costs (R. 111, 119). The total amount of the annuity payments held taxable by the Board for 1934 was $28,138.66, and a deficiency in income tax for the year 1934 of $2,162.08 was determined (R. 120). The court below affirmed (R. 153).

ARGUMENT

Section 22 (b) (2) of the Revenue Act of 1934 provides a special scheme for the taxation of annuity payments. Any payments in excess of three percent of the "consideration paid" for the annuity is excluded from gross income until the aggregate amount so excluded equals the aggregate consideration paid. Thereafter the total amount of the annuity payments is included in gross income. The questions here are (1) whether Section 22 (b) (2) applies to the annuity payments received by petitioner; (2) if so, whether Section 22 (b) (2) is constitutional; and (3) if Section 22 (b) (2) is applicable and valid, whether the "consideration paid" for the annuities is all, or only a part, of the amounts transferred by petitioner to the institutions.

1. Petitioner urges that Section 22 (b) (2) is not applicable here because (a) the annuity contracts were made with charitable institutions, and (b) they were made prior to the enactment of the Revenue Act of 1934.

(a) The contention that Section 22 (b) (2) does not apply to annuity contracts made with charitable institutions is specious. The section speaks of "Amounts received as an annuity under an annuity * * * contract"; it draws no distinction between annuity payments made by a charitable institution and such payments made by other persons. The sole requirements for the application of the section are that the payment be received "as an annuity" and "under an annuity * * * contract"; those requirements are concededly met in the present case.

Petitioner's contention in this respect is based solely on a colloquy on the floor of the Senate between Senators Austin and Harrison (Pet. 27–28); in reply to a question by Senator Austin, Senator Harrison indicated that Section 22 (b) (2) does not apply to a taxpayer who purchases an annuity from a charitable institution. However, a reading of the next few lines of the Congressional Record shows that Senator Harrison, in giving the answer quoted by petitioner, had misunderstood Senator Austin's question, for he thereafter indicated an opposite view (78 Cong. Rec., Part 6, p. 5916).

(b) There is likewise no merit in petitioner's contention that Section 22 (b) (2) should be construed to apply only to annuities purchased after the enactment of the Revenue Act of 1934. The section contains no such provision and none can be read into its language. The authorities relied upon by the petitioner (Pet. 12) to the effect that estate

and gift taxes should not be given a retroactive effect are inapplicable; the tax here is not on an antecedent transfer but on income received after the Act became effective. Similar taxes have frequently been upheld by this Court over the objection that they were arbitrarily retroactive. See *Reinecke* v. *Smith,* 289 U. S. 172, 175; *Burnet* v. *Wells,* 289 U. S. 670, 682–683, and cases cited.

2. Petitioner's attack on the validity of Section 22 (b) (2) is likewise without merit. Its principal contention in this respect is that in any case where the beneficiary of an annuity contract has not received back annuity payments equalling the consideration paid for the contract, the requirement that a portion of the annuity payments (i. e., so much as is not in excess of three percent of the consideration paid for the contract) must be included in gross income imposes a direct tax upon capital rather than a tax upon income.

The argument is based on the fallacious premise that until the consideration paid for an annuity contract is recouped, all payments under the contract are a return of capital. This is plainly not the case. As pointed out in the House and Senate Committee Reports on the 1934 Act (*infra,* pp. 13–15), "Payments to annuitants are, in fact, based upon mortality tables which purport to reflect a rate of return sufficient to enable the annuitant to recover his cost and in addition thereto a low rate of return on his investment". Section 22 (b) (2) is designed to tax that portion of each annuity pay-

ment which does in fact constitute income. However, because it would be almost impossible to determine the precise amount of income which is included within any particular annuity payment, Congress fixed three percent of the cost of the annuity as the amount to be treated as income; it recognized that "While the percent used is arbitrary, it approximates the rate of return in the average annuity" (*infra*, p. 14).

None of the authorities cited by petitioner (Pet. 12–13, 31–37) throws any doubt upon the validity of the Congressional action in this respect. In *Burnet* v. *Logan*, 283 U. S. 404, upon which petitioner chiefly relies, the taxpayer had sold shares of stock in a company engaged in mining ore for cash and a royalty upon each ton of ore thereafter mined. The Court held that the taxpayer was not subject to income tax upon any of the royalties until they exceeded her cost basis. The case is clearly distinguishable, both because of the difference in the character of royalty and annuity payments and because the *Logan* case involved no statute corresponding to Section 22 (b) (2).

A much closer analogy to the present case is to be found in Section 44 (a) of the Revenue Act of 1934, which provides that any person who regularly sells personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when pay-

ment is completed bears to the total contract price. The vendor in the case of an installment sale, like the annuitant here, does not immediately recoup his capital and there is a possibility he may never recoup it. Yet the validity of the provision for treating a portion of each installment payment as income has never been questioned. Cf. *Pacific National Co.* v. *Welch,* 304 U. S. 191; *Nuckolls* v. *United States,* 76 F. (2d) 357 (C. C. A. 10th); *Lawler* v. *Commissioner,* 78 F. (2d) 567 (C. C. A. 9th).

3. If Section 22 (b) is applicable and valid, the judgment below is correct, irrespective of whether the "consideration paid", within the meaning of Section 22 (b), is the entire amount transferred by the taxpayer or, as the court below held, is only so much of that amount as would be necessary to buy comparable annuities from an insurance company. Under the decision below, the total amount of the annuity payments to be included in gross income for 1934 is $28,138.66. If, on the other hand, the entire amount transferred by the taxpayer to the institutions is to be treated as the "consideration paid", then three per cent of that amount, or approximately $37,000, is to be included in gross income. Consequently, even if petitioner were correct in its contention that the entire amount transferred should be deemed the "consideration paid", the decision of the Board was properly affirmed.

But in any event, we believe petitioner's contention to be plainly erroneous. As the Board

pointed out in its opinion (R. 108), the record establishes beyond question that the taxpayer was not interested solely in purchasing annuities; in the case of every transfer she intended to make a gift as well. If she had been interested simply in purchasing annuities, there were insurance companies readily available whose rates were substantially lower than the amounts which the taxpayer turned over to the charities. Yet the taxpayer made no investigation to ascertain how large an annuity she could have purchased for the amounts transferred but only as to how much each particular institution would pay her. At least one of the institutions involved characterized the transfer to it as a "most generous gift" (R. 122). The Board's conclusion is inescapable, therefore, that the transfers made were in part consideration for an annuity and in part a gift (R. 108).

Having reached this conclusion, the Board necessarily had to determine what portion of the amounts transferred were in consideration for the annuities. Since petitioner furnished no other proof on this question, the Board used as the criterion the cost of comparable annuities which could have been purchased from five large insurance companies. This criterion seems eminently fair and reasonable; taxpayer suggests no valid reason why the Board erred in adopting it, or, indeed, what other criterion the Board could or should have adopted. We believe it clear, therefore, that the court below correctly approved the Board's action.

CONCLUSION

The decision below is correct and is not in conflict with any decision of this Court or of any other circuit court of appeals. The petition for a writ of certiorari should, therefore, be denied.

Respectfully submitted.

Francis Biddle,
Solicitor General.

November, 1940.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

* * * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * *

(2) *Annuities, Etc.*—* * * Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year), until the aggregate amount excluded from gross income under this title or prior income tax laws in respect of such annuity equals the aggregate premiums or consideration paid for such annuity. * * *

* * * * *

Treasury Regulations 86, relating to the Revenue Act of 1934:

ART. 22 (b) (2)-2. *Annuities.*—Amounts received as an annuity under an annuity or endowment contract include amounts received in periodical installments, whether annually, semiannually, quarterly, monthly,

or otherwise, and whether for a fixed period, such as a term of years, or for an indefinite period, such as for life, or for life and a guaranteed fixed period, and which installments are payable or may be payable over a period longer than one year. * * * As soon as the aggregate of the amounts received and excluded from gross income equals the aggregate premiums or consideration paid for such annuity, the entire amount received thereafter in each taxable year must be included in gross income. The provisions of this article may be illustrated by the following examples:

Example (1).—A bought in 1933, for $50,000 consideration, a life annuity, payable in annual installments of $5,000. For the calendar year 1934 he would be required to include in gross income $1,500 of the $5,000 received during that year (3 percent of $50,000), $3,500 being exempt. If A should live long enough to receive as exempt $50,000, then all amounts he has received thereafter under the annuity contract would be included in gross income.

* * * * *

Congressional Committee Reports, relating to Section 22 (b) (2) of the Revenue Act of 1934:

H. Rep. No. 704, 73d Cong., 2d Sess., p. 21:

> Section 22 (b) (2). Annuities, etc.: The present law does not tax annuities arising under contracts until the annuitant has received an aggregate amount of payments equal to the total amount paid for the annuity. Payments to annuitants are, in fact, based upon mortality tables which purport to reflect a rate of return sufficient to enable the annuitant to recover his cost and in ad-

dition thereto a low rate of return on his investment. The change continues the policy of permitting the annuitant to recoup his original cost tax-free but requires him to include in his gross income a portion of the annual payments in an amount equal to 3 percent of the cost of the annuity. While the percent used is arbitrary, it approximates the rate of return in the average annuity.

Statistics show that an increasing amount of capital is going into the purchase of annuities, with the result that income taxes are postponed indefinitely. The change merely places the return of this form of investment on the same basis as other forms of investment by taxing that portion of each payment which in fact constitutes income.

S. Rep. No. 558, 73d Cong., 2d Sess., p. 23:

SECTION 22 (b) (2). *Annuities.*—The present law does not tax annuities arising under contracts until the annuitant has received an aggregate amount of payments equal to the total amount paid for the annuity. Payments to annuitants are, in fact, based upon mortality tables which purport to reflect a rate of return sufficient to enable the annuitant to recover his cost, and in addition thereto, a low rate of return on his investment.

The House bill continues the policy of permitting the annuitant to recoup his original cost tax-free but requires him to include in his gross income a portion of the annual payments in an amount equal to 3 percent of the cost of the annuity. While your committee is in agreement with the change made by the House, it was thought advisable to continue the policy of not taxing any por-

tion of the amount received from an annuity until the aggregate amount of payments equal the total amount paid for the annuity in cases where the aggregate amount received by the annuitant from all his annuities is not more than $500. The following example illustrates the change made:

Example: "A", an individual, received during the calendar year the following amounts from annuities: annuity no. 1, $450; annuity no. 2, $300; and annuity no. 3, $150. In the case of annuity no. 1, "A" prior to 1934 received aggregate payments equal to the aggregate premiums paid. In the case of annuity no. 1, "A" reports the entire amount of the annuity because all of his capital has been returned. In the case of annuity no. 2 and annuity no. 3, "A" is required to include in gross income 3 percent of the consideration paid for each such annuity. The $500 exemption will not apply in such a case because the total annuity payments received by "A" during the taxable year exceed that amount.

H. Conference Rep. No. 1385, 73d Cong., 2d Sess., p. 17:

Amendment no. 14: The House bill requires an annuitant to include in his gross income a portion of the annual receipts in an amount equal to 3 percent of the cost of the annuity. The Senate amendment excepts from the House change persons whose aggregate receipts from annuities in the year do not exceed $500, and makes some minor changes in phraseology. The House recedes with an amendment rejecting the $500 exception.

U. S. GOVERNMENT PRINTING OFFICE: 1940